

E. DISCRETIONARY RELIEF UNDER IRC 7805(b) AND REG. 1.9100-1

1. Introduction

The purpose of this topic is to discuss various aspects of discretionary relief available to exempt organizations. The pertinent provisions that provide such relief are IRC 7805(b) and Reg. 1.9100-1. IRC 7805(b) is used to determine the extent to which any ruling will be applied without retroactive effect. Reg. 1.9100-1 provides authority to grant a reasonable extension of time fixed by regulations for the making of an election or application for tax relief. This topic will explore the background, procedures and standards applicable to both provisions. Discretionary relief does not mean arbitrary or capricious decisions. Neither does it result in the exercise of uncontrolled power by the appropriate Service official. In the context of IRC 7805(b) and Reg. 1.9100-1, discretion to grant relief is limited by certain identifiable standards. Relief is sought by exempt organizations in accordance with specified, published procedures. In all cases, discretion to act is limited and standardized.

2. Relief under IRC 7805(b)

a. Background

Prior to the Revenue Act of 1921 the Service had no authority to ease any hardship by prospective application of the correction of a mistake of law. Section 1314 of the Revenue Act of 1921 provided the Commissioner with discretion to apply reversals of regulations with only prospective effect. Section 506 of the Revenue Act of 1934 permitted Internal Revenue rulings as well as regulations or Treasury Decisions to be applied without retroactive effect. During this time, and prior to 1954, no standards had been published or established with respect to the application of nonretroactive relief to rulings. Cases were considered on a case-by-case basis. Rev. Rul. 54-172, 1954-1 C.B. 134, set forth for the first time the authority, policy, and procedures in issuing rulings to taxpayers and the effect of such rulings. Since 1954 the general standards for applying 7805(b) relief have been restated several times, generally in the form of Revenue Procedures. The latest restatement for the Assistant Commissioner (Employee Plans and Exempt Organizations) can be found in Rev. Proc. 80-24, 1980-1 C.B. 658.

b. Procedures for Requesting Relief

An exempt organization that desires relief under IRC 7805(b) must submit a request for a ruling to limit the retroactive effect of revocation or modification of a ruling letter. The requirements for requesting a ruling in general are set forth in section 6 of Rev. Proc. 80-24. As in the case of all ruling requests, a request for relief under IRC 7805(b) must contain a statement of the relief sought together with an explanation of the reasons and arguments in support of the relief requested. The exempt organization should submit a substantive discussion of 7805(b) standards as they relate to its situation. The request for relief may be made in conjunction with a pending ruling request, or it may be made separately. In either instance, a conference to discuss the matter will be afforded the organization where an adverse position is indicated. If the organization's request for relief is made initially, or as part of a pending ruling request, or is made before the conference of right on the substantive issues, the 7805(b) issue will be discussed at the organization's conference of right. The organization also has a right to a conference when the 7805(b) issue arises as part of a technical advice request. This would occur when the key District Director proposes to revoke or modify a determination letter. The organization could request the key District Director to limit the modification or revocation of the determination letter by requesting the key District Director to seek technical advice from the National Office. All cases in which relief under IRC 7805(b) is either recommended by the key District Director or the Appeals Office, or is requested by the organization, must be referred to the National Office. See IRM 7(10)(12)6.1(3). Such referral is required because District Directors generally do not have authority to exercise 7805(b) relief except with regard to certain employee plans determinations. Such authority rests in the hands of the Commissioner, the Assistant Commissioner, or the Deputy Assistant Commissioner. When the key District Director requests technical advice on a 7805(b) issue, the exempt organization must submit the same information as that specified for ruling requests.

c. Standards for Granting 7805(b) Relief

In general, a ruling may be revoked or modified at any time. If a ruling is revoked, revocation applies to all open years under the statutes unless the Commissioner, the Assistant Commissioner, or Deputy Assistant Commissioner exercises discretionary authority under IRC 7805(b) to limit the retroactive effect of the revocation or modification. Section 13.04 of Rev. Proc. 80-24 sets forth the following situations that would affect the modification or revocation of a ruling:

- (1) a notice to the taxpayer to whom the ruling originally was issued;
- (2) enactment of legislation or ratification of a tax treaty;
- (3) a decision of the United States Supreme Court;
- (4) issuance of temporary or final regulations; or,
- (5) issuance of a revenue ruling, a revenue procedure, or other statement published in the Internal Revenue bulletin.

Section 13.05 of Rev. Proc. 80-24 contains the most important aspects of 7805(b) relief. The following statement is at the heart of each 7805(b) decision made:

"Except in rare or unusual circumstances, the revocation or modification of a ruling will not be applied retroactively with respect to the taxpayer to whom the ruling was originally issued or to a taxpayer whose tax liability was directly involved in such ruling, if:

- (1) there has been no misstatement or omission of material facts,
- (2) the facts subsequently developed are not materially different from the facts on which the ruling was based,
- (3) there has been no change in the applicable law,
- (4) the ruling was originally issued with respect to a prospective or proposed transaction, and
- (5) the taxpayer directly involved in the ruling acted in good faith in reliance upon the ruling and the retroactive revocation would be to the taxpayer's detriment."

In summary form, this is a classic statement of standards applicable to equitable relief. The notions of "clean hands," good faith, material change, and detrimental reliance are all set forth in the Revenue Procedure. In practice, where

there has been no change in the applicable law, an exempt organization that tells the truth, acts in good faith, and relies on its ruling will be granted discretionary relief under IRC 7805(b). It should be noted that an exempt organization, like any other taxpayer, may not rely on a ruling issued to another organization. Further, a ruling issued to an organization with respect to a particular transaction represents Service position on that transaction only. Regarding continuing actions or a series of actions, if a ruling is issued covering such a situation and it is determined that the ruling was in error or no longer reflects Service position, the Assistant Commissioner ordinarily will limit retroactivity of the revocation or modification to a date not earlier than that on which the original ruling is modified or revoked. What this provides is true prospective application of a Service position and generally complete protection for the organization to which the ruling was issued. In like manner, retroactivity of the revocation or modification of a ruling or determination letter recognizing exemption will ordinarily be limited to a date not earlier than that on which the original ruling or determination letter is modified or revoked. See. Rev. Proc. 80-25, 1980-1 C.B. 667, section 13.01. Thus, the same protection is available on a prospective basis where an organization's exemption is being revoked or modified.

3. 1.9100-1 Relief

a. Background

Under Reg. 1.9100-1 the Commissioner has discretion, upon a showing of good cause by a taxpayer, to grant a reasonable extension of the time fixed by the regulations for making an election or application for relief in respect to income tax provided:

- (1) the time for making the election or application is not expressly prescribed by the statute;
- (2) the request for the extension is filed with the Commissioner within a period of time the Commissioner considers reasonable under the circumstances; and,
- (3) it is shown to the Commissioner's satisfaction that granting the extension will not jeopardize the Government's interests.

The concept of 1.9100-1 relief in the exempt organizations area is a relatively recent phenomenon. However, such relief has been available for some time in other areas of tax administration. For example, Technical Information Release 336, dated September 18, 1961, and Rev. Proc. 61-30, 1961-2 C.B. 568, provide that the Service will consider requests for granting extensions of time for the filing of consents by certain shareholders who failed to file timely consents to elections by small business corporations under IRC 1372. Other areas have also been the subject of 1.9100-1 relief.

In 1980, the question presented was whether Reg. 1.9100-1 had any applicability to the area of Reg. 1.508-1. IRC 508(a) provides generally that organizations organized after October 9, 1969, shall not be treated as organizations described in IRC 501(c)(3) unless they give notice to the Secretary that they are applying for recognition of IRC 501(c)(3) status. Reg. 1.508-1(a)(2)(i) provides that the required "notice" consists of a "properly completed and executed Form 1023, Exemption Application," filed within 15 months from the end of the month in which the organization was organized. This regulation also provides that a request for an extension of time to file the notice should be submitted to the District Director, and that such request would be approved if it is demonstrated that additional time is required. Organizations that apply for exemption under IRC 501(c)(3) and do not meet any of the exceptions of IRC 508(c), are granted prospective exemption from the date their Application for Exemption was submitted, rather than from their date of formation. The key question became whether the notice and filing requirements of IRC 508 and Reg. 1.508-1(a)(2)(i) constitute either an "election" or "application for relief in respect of tax" within the meaning of Reg. 1.9100-1.

Because the 508 notice requirements do not involve any sort of choice or alternative for an exempt organization, it was decided that no "election" was present here. However, it was also decided that the 508 notice requirements do constitute an "application for relief in respect of tax," and therefore Reg. 1.9100-1 is applicable in these instances. Thus, Reg. 1.9100-1 relief may be granted to organizations that file late if the other requirements of Reg. 1.9100-1 are satisfied. If those requirements are satisfied, then an extension of time under Reg. 1.9100-1 may be appropriate if good cause is shown and the Commissioner, in his discretion, believes relief is warranted.

b. Procedures for Requesting Relief

The general statement of procedures with regard to applications for recognition of exemption under IRC 501 is found in Rev. Proc. 80-25, 1980-1 C.B. 667. However, this Revenue Procedure does not contain the latest thinking with respect to IRC 508 and Reg. 1.9100-1. A number of possibilities are available to an organization that submits its application for exemption beyond the requisite 15 month period of Reg. 1.508-1(a)(2)(i). The organization may choose to accept prospective exemption from the date it submitted its Application Form 1023. However, this may result in tax being due for prior years during which the organization was not exempt, FICA and FUTA problems, and lack of deductibility for donors. If the organization's only problem is exemption from income tax, it may accept prospective exemption under IRC 501(c)(3), and submit an Application Form 1024 requesting exemption under IRC 501(c)(4) for prior years. Rev. Rul. 80-108, 1980-1 C.B. 119, holds that an organization that otherwise qualifies for exemption under both IRC 501(c)(3) and 501(c)(4), but that did not file for recognition of exemption under IRC 501(c)(3) within the requisite 15 months may be exempt under IRC 501(c)(4) from the date of its inception. This would be a good approach for organizations having no problems with respect to FICA and FUTA, or deductibility of contributions. Organizations that need retroactive exemption under IRC 501(c)(3) may now request relief under Reg. 1.9100-1.

Rev. Rul. 80-259, 1980-2 C.B. 192, discusses a situation in which an organization met one of the exceptions of IRC 508(c) during its first three taxable years. At the end of the Rev. Rul., it was publicly stated for the first time that the Service will consider applying Reg. 1.9100-1 relief to extend the time for satisfying the notice requirement of IRC 508(a).

The requirements for requesting an extension of time for submitting an application are contained in Rev. Proc. 79-63, 1979-2 C.B. 578. An exempt organization requesting such an extension should submit a substantive discussion of the 1.9100-1 standards as they relate to its situation. Section 4.02 of Rev. Proc. 79-63 provides that the information submitted should include a chronological account of the events leading to the failure to make the application. The information should also include the names and current addresses of each person having knowledge or information about the events that led to the failure to make a timely application and all relevant documents. Any other information bearing on the request may be submitted. Requests for extensions of time under Reg. 1.9100-1 and any additional information must be accompanied by the following declaration:

"Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and to the best of

my knowledge and belief, the facts presented in support of this request are true, correct and complete."

This declaration must be signed by an officer of the exempt organization who has knowledge of the facts, and not by an authorized representative. Supporting affidavits by an authorized representative or other person must also be accompanied by a comparable declaration.

Requests for extensions of time for filing must be submitted to the Assistant Commissioner (Employee Plans and Exempt Organizations). Although authority to exercise discretionary relief under Reg. 1.9100-1 is vested in the Commissioner, such authority was redelegated to Division Directors by Delegation Order 183, dated June 23, 1980, and Assistant Commissioner (EP/EO) Delegation Order 14, dated August 13, 1980. If a request for an extension under Reg. 1.9100-1 is received by a key District Director or an Appeals Office, technical advice should be requested of the National Office. All cases in which relief under Reg. 1.9100-1 is requested must be referred to the National Office. The Manual is being updated to reflect this. When a 1.9100-1 case takes the form of a technical advice request, the exempt organization must submit the same information as that specified for direct requests. It should be noted that in the event an adverse position is indicated, the organization will be afforded the right to a conference in the National Office.

c. Standards for Granting 1.9100-1 Relief

Once a request for section 1.9100-1 relief is received, it is reviewed for completeness, including the required declaration and other information. A memorandum is prepared from the Chief, Exempt Organizations Technical Branch to the Director, Exempt Organizations Division, discussing the issue, facts, law, arguments for and against relief, and a recommendation including the precise time period for which 1.9100-1 relief is to be granted. Although all relevant facts are considered in deciding whether an extension of time for filing an application is warranted, the five factors of Rev. Proc. 79-63 are most important. Section 4.01 of Rev. Proc. 79-63 are most important. Section 4.01 of Rev. Proc. 79-63 contains the following specific standards governing 1.9100-1 relief:

(1) Due diligence of the taxpayer

What action, if any, did the taxpayer take to determine the existence of and requirements for the election or application? In this regard, did the taxpayer consult an

attorney or accountant knowledgeable in tax matters or communicate with a responsible employee of the Service? Further, what action, if any, did the taxpayer take to make the election or application?

(2) Prompt action by the taxpayer

Is the taxpayer requesting the extension within a reasonable time after discovering a deadline that could not be met or, alternatively, within a reasonable time after discovering a deadline that has already passed? Was the discovery made within a reasonable time after passage of the deadline? Did the taxpayer take reasonable action under all the circumstances to deal promptly with a missed deadline?

(3) Intent of the taxpayer

Did the taxpayer intend to make the election or application on time? If the taxpayer knew of the election or application, was the taxpayer's failure to elect or apply on time due to mere inadvertence or to significant intervening circumstance beyond the taxpayer's control? Have the taxpayer's actions been consistent with the intent to make the particular election or application, or has the taxpayer taken action inconsistent with the intent to make the particular election or application?

(4) Prejudice to the interests of the Government

Would granting the extension neither prejudice the interests of the Government nor cause undue administrative burden? For example, has the taxpayer used or had the opportunity to use hindsight to the Government's prejudice by actions based on knowledge of events occurring after the time when the taxpayer would have had to act in order timely to make the election or application?

(5) Statutory and regulatory objectives

Would granting the extension be consistent with the objectives of the underlying statute and the regulatory election or application provision?

The Application of these standards to a simple situation is as follows: A charitable organization places its Application Form 1023 in the hands of a knowledgeable attorney or accountant who agrees to submit the Application within the requisite 15 month period, but fails to do so. As soon as the organization discovers that no application for exemption has been submitted and that the 15 month period has passed, it promptly submits its Application Form 1023, and requests relief under Reg. 1.9100-1. All of the facts indicate that the organization had always intended to be exempt under IRC 501(c)(3). There is no reason why granting such relief would prejudice the Government or cause undue administrative burden. Finally, the "notice" requirements of IRC 508 would not be frustrated since the organization had done all that was reasonably necessary to provide notice within the prescribed time. Under the circumstances relief under Reg. 1.9100-1 would be appropriate, and the organization's exempt status under IRC 501(c)(3) would be retroactive to its date of formation. It should be noted that this is a rather uncomplicated example of a 1.9100-1 case. Other facts and circumstances unfavorable to the organization might preclude relief under Reg. 1.9100-1, for example if the organization were dilatory in acquiring the services of an attorney so that he or she does not have adequate time to prepare the application, an adverse ruling might be warranted.